DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

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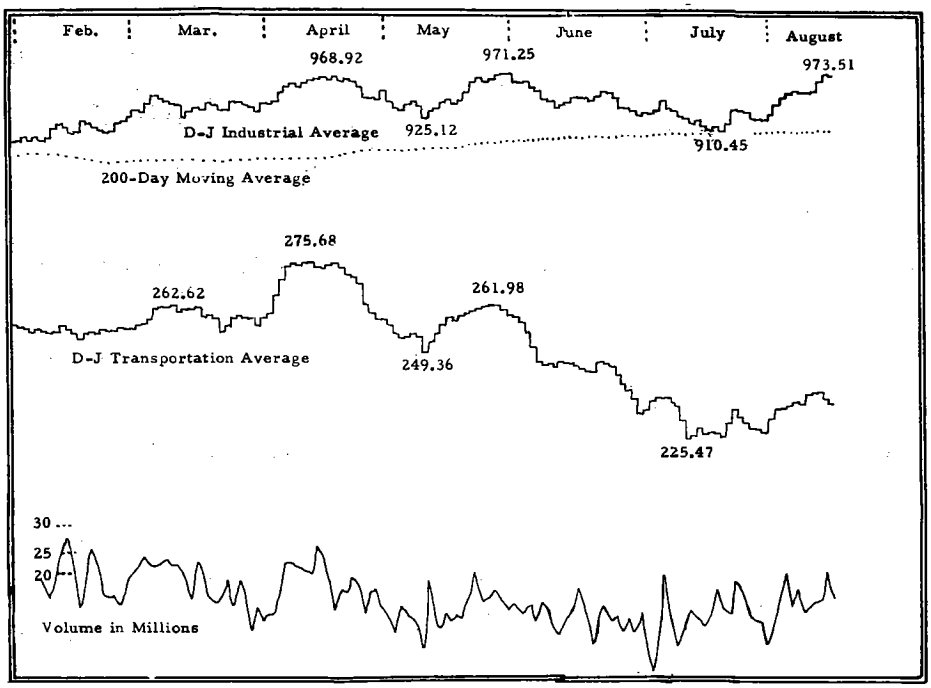
THE MARKET: I believe the weekly chart on page 2 offers one of the best available perspectives on today's market. For thirty weeks running the Dow Industrials fluctuated within a range bordered by 971.25 (closing basis) on the upside and 910.45 on the downside. Then, on July 20, the trend for the Dow turned strongly upwards, and on August 14 the Dow spurted over its (May) 971.25 to record a new recovery high of 973.51.

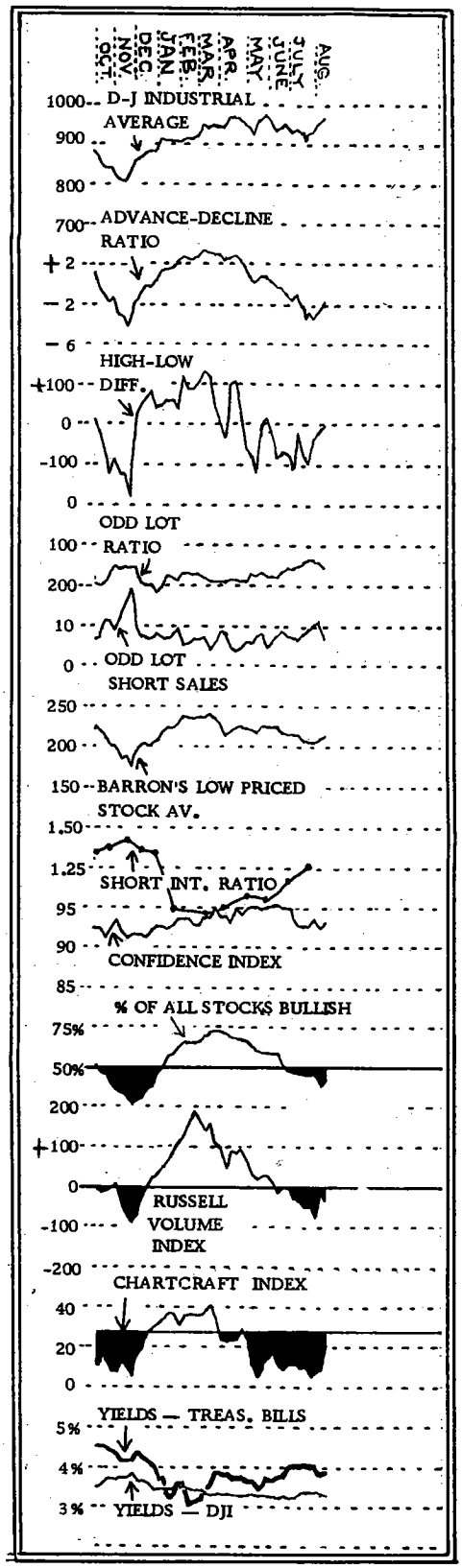
From April to July the Transports followed a bearish pattern, recording a 1972 low on July 12 of 225.47. From there, as noted in the last Letter, the Transports (as did Industrials) formed an upward zig-zag pattern as they sluggishly followed Industrials upward in the "summer rally" (see chart of Averages, bottom of page).

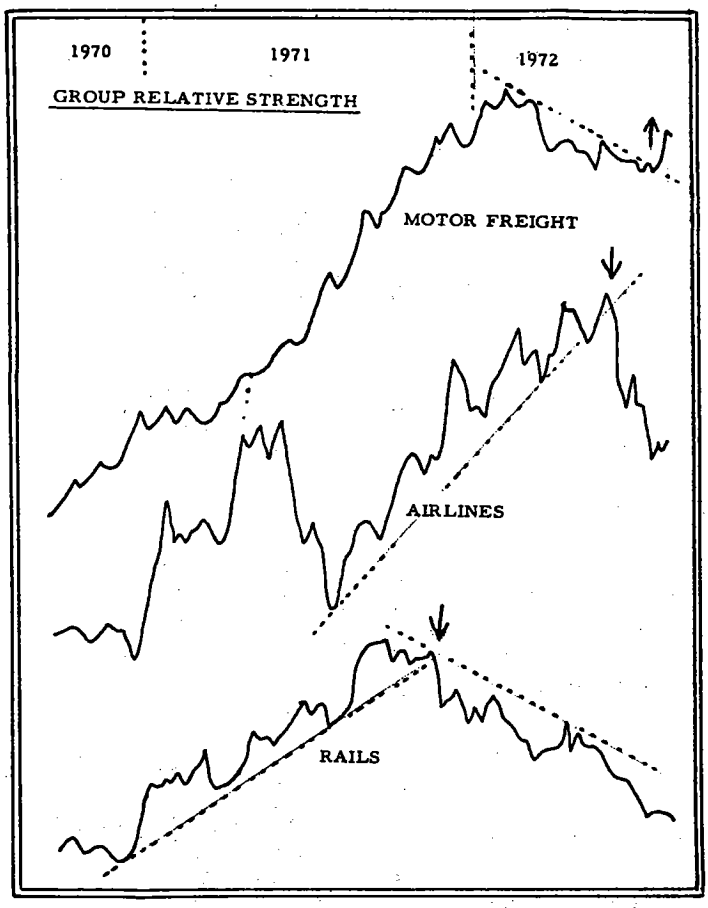
Since the confirmation principle is one of the cornerstones of Dow Theory, it is most important to note that the Transports have lagged badly during the current rally, and on days when Industrials advanced sharply Transports have tacked on less than a point. This means that the new recovery high for Industrials is unconfirmed, always a cause for concern to followers of the Dow Theory. As noted in the last Letter, the Dow Theory states that a movement of one Average unconfirmed by the other is not valid, and, in fact, such solo movements are more often than not deceptive. Time will tell in the current instance.

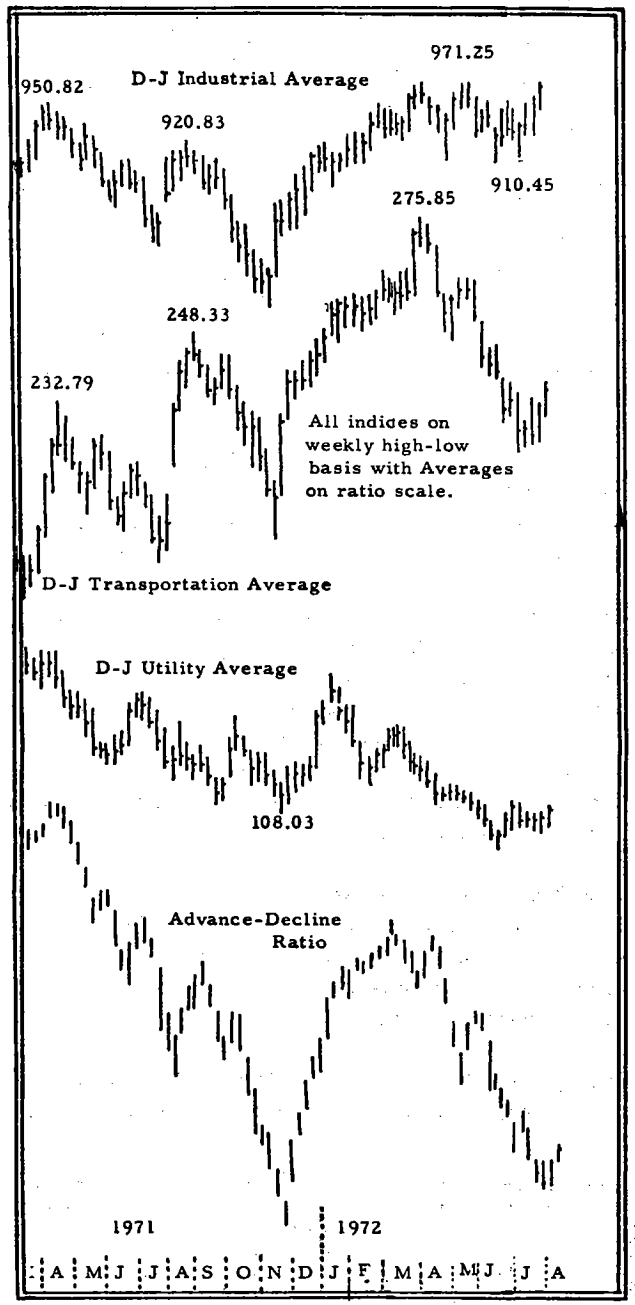
The Utility Average, bellwether leader all through the bull market of 1949 to 1966, broke below its 1971 low in June of this year and has moved generally sideways ever since. Since the Utility Average may be considered the "investment grade" sector of the market, the current status of Utilities would suggest that investment money is highly cautious at this time.

Finally, the advance-decline ratio reflects the advancing or declining tendencies of the majority of issues. The A-D ratio recorded a low for 1972 on July 31, and that









low was only slightly above the November, 1971, low. Thus, the majority of stocks have been unable to make much upside progress, despite a very superior performance by the Dow Industrials.

As an interesting aside on the sluggish action of the Transports, I have charted the relative strength of each of the three components of the Transport Average, motor freight, airlines and rails. Note that the relative strength of the rail group turned bearish (down arrow) in late 1971, the relative strength of the airlines turned bearish in June of this year, and only motor freight is now bullish, having turned up last month (July). Thus, with two of the three components of the Transportation Average acting poorer than the market on a relative strength basis, the Transport Average is injecting a serious question into the whole technical market picture.

On page 3 (at top) we see the primary trend index (PTI), a complex index made up of eight critical technical measurements, including four stock averages, a bond average, the A-D ratio, most-active stocks and the high-lows. The latest PTI development, as noted in the last Letter, was an upside breakout through steep descending trendline F. On August 11 the PTI rose above its late-July peak at D. The hurdling of D is better than nothing, but as seen on the chart, the PTI is now hopelessly behind the Dow (during the rise to the April, 1972, highs, the PTI led the Dow).

What this means is that technical strength is lagging badly and the majority of technical indicators have performed in lack-luster fashion during this rise.

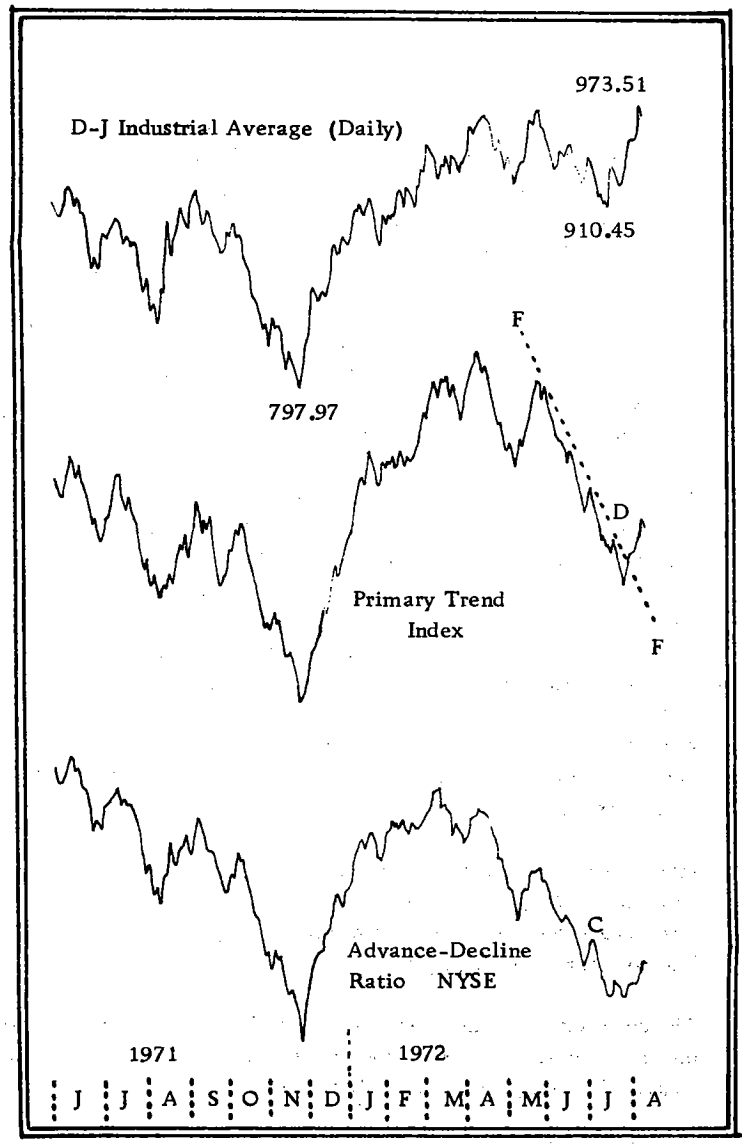
At the bottom of the chart we see the daily A-D ratio, and here again we see a picture of almost pathetic resistance to the upward move of the Dow and many glamor stocks. The A-D ratio is currently below its early-July peak at C, so that here again we have a picture of flagrant non-confirmation.

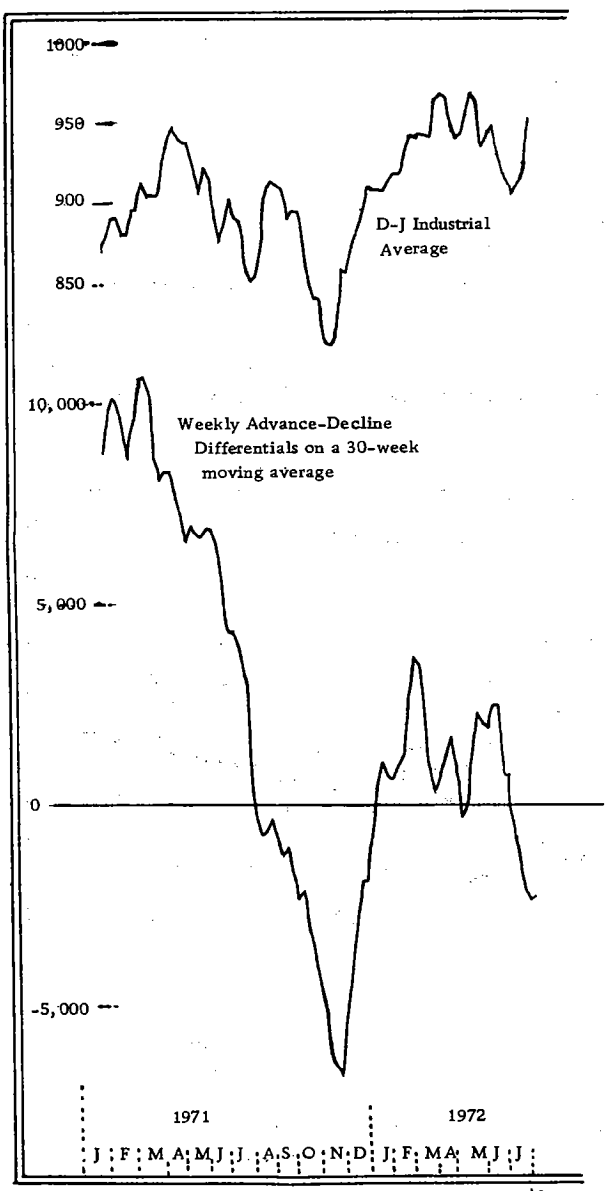
LONG-TERM BREADTH: I first introduced the accompanying chart in Letter 535. The chart follows the path of the 30-week moving average of the advance-decline ratio. The figures for the indicator are computed as follows: The pluralities of

advances over declines (vice versa if more declines than advances) are tabulated from the weekly statistics in Barron's. These pluralities are then simply arranged in the form of a 30-week moving average.

In effect, then, this chart provides us with the total of the advance-decline pluralities over the past 30-weeks (or a little more than half a year). The chart shows two things, (1) If the 30-week average is above zero it means that there have been more advances than declines on average over the past half year. The converse, of course, is true if the line is below zero. (2) The 30-week moving average shows us the long-term trend of advance-decline pluralities.

Studying the chart, we note that the peak for the long-term A-D occurred in March, 1971. From there the A-D collapsed to a low in November, 1971. A new rise took the indicator to a level of about 3600 in early-March, 1972. This was the peak of profitability for those who bought stocks near the 1971 lows. In May, the A-D dipped tem-





porarily below zero, it rallied into June, then started slipping again.

During July the long-term A-D line dropped well below zero, thereby forming a major downward zig-zag as it plunged under the May low to its lowest level of 1972. The 30-week moving average of the A-D line is now saying that the trend of breadth is down and that the majority of NYSE issues have been in declining trends over the past half year.

This whole performance is remarkable in that the Dow Industrials have held so well in the face of a collapse in the A-D ratio. What the market seems to be saying is that whatever forces have hurt the big Dow stocks to a mild degree have hurt the majority of other stocks to a much more obvious degree. It is, to my mind, one of the most split and schizophrenic markets seen in years.

WEEKLY HIGH-LOWS: One of the gauges of the strength (or weakness) of an advance is the number of new highs vs. new lows produced. During a strong advance the majority of stocks will be swept upward by the bullish tide. If the strength is to continue, the new high list will expand (while new lows contract). During bullish moves stock after stock will push to new highs for the year. And near the peak of strength not only will the new high of last month push to new highs this month, but other issues

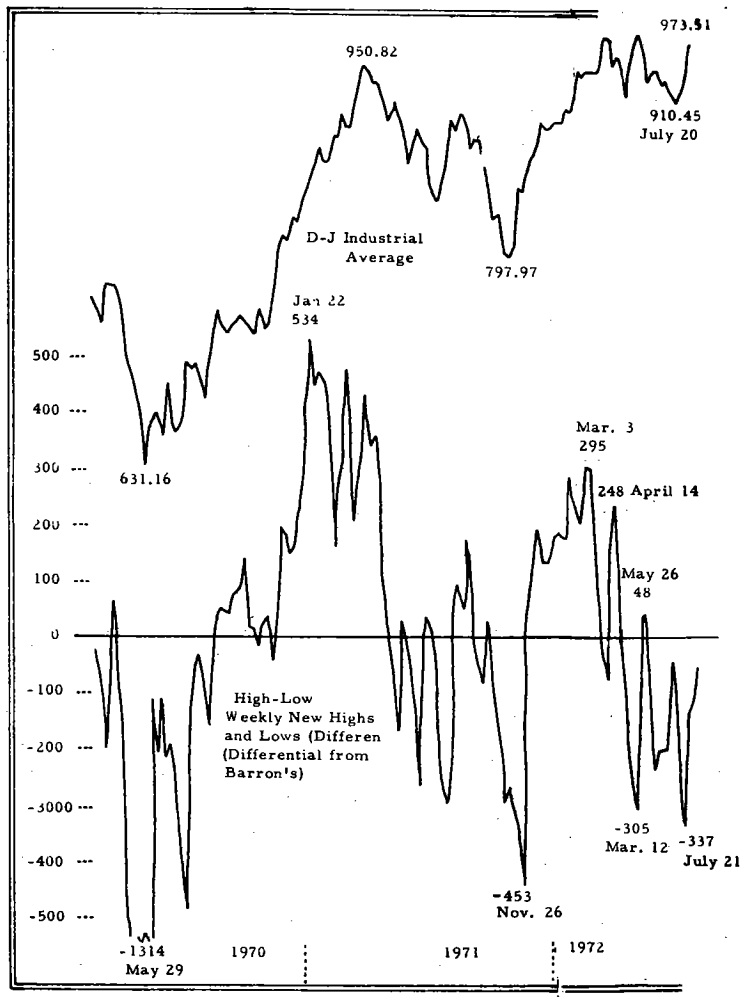
will also join the new high parade. Such action can be seen on the accompanying chart during the strong 1970 to early-1971 rise.

This chart shows the weekly high-low differential (weekly figures from Barron's) for the past 2½ years. Note that the peak of true strength (and this checks with the 30-week moving average of the A-D ratio study) came on January 22, 1971, as the high-low differential climbed to 534. The high-lows then dropped off as the Dow continued its advance to 950.82.

From there a broad decline (presaged by a drop-off in the index peaks — see chart) took the Dow down to a November, 1971, low of 797.97. The index recorded a low of minus 453 on November 26.

A new advance carried into 1972 with the high-low index reaching a peak of plus 295 on March 3. From there, despite a series of declining index peaks the Dow pushed up to a 1972 high of 971.25. In the face of the declining breadth and high-lows, the Dow slid off. Meanwhile, a most extraordinary phenomenon was taking place. A reading of minus 305 was seen on the index on March 12, and on July 21 the index sank to a low of minus 337. With the Dow still above 900, it was obvious from the index readings that the bulk of the market was suffering severe losses.

From the July 20 low of 910.45, the Dow has now bettered the May high. The latest reading on the high-low index shows -51. This constitutes the biggest high-low divergence at a new peak yet seen.

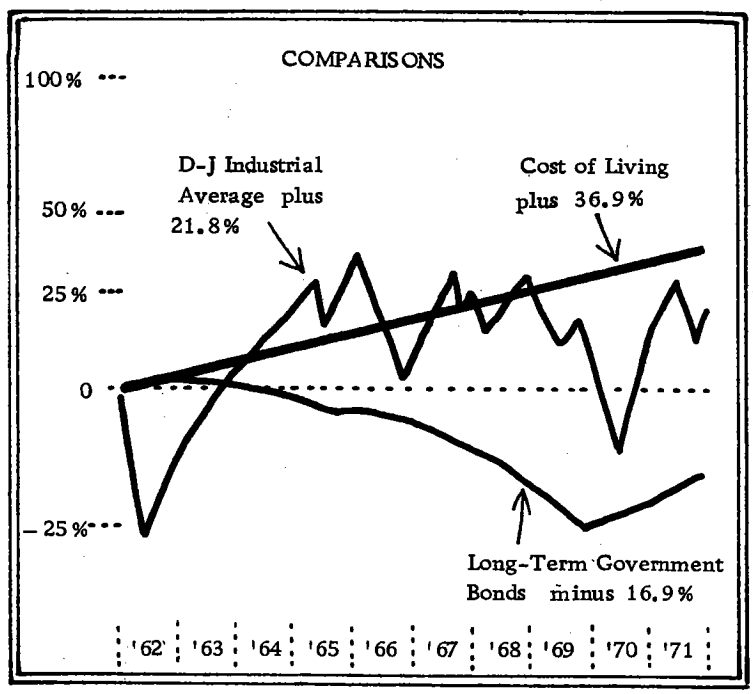


The chart shows the divergence between the Dow and the high-low index growing larger with each fresh rally attempt. While the index could yet climb above its March 3 peak of plus 295 thereby clearing the air, it has (so far) shown no inclination to do so. The Dow, so to speak, is on another remarkable "solo flight."

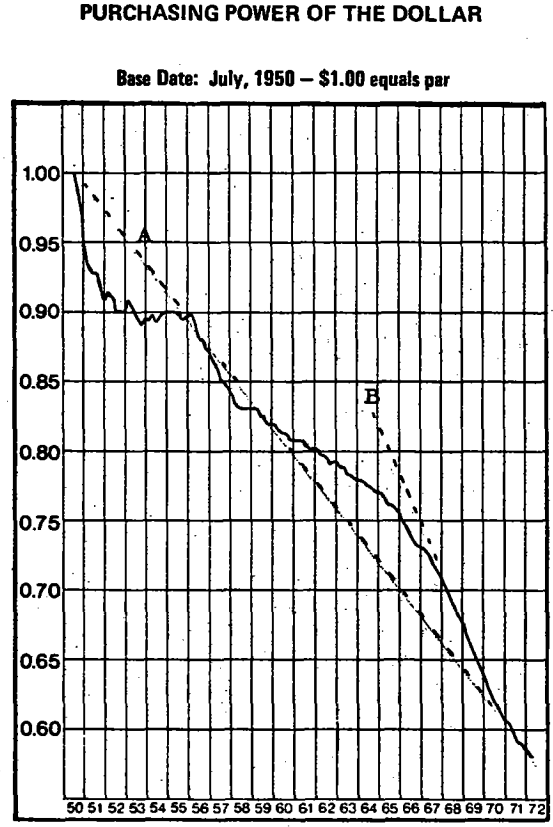
THE THIEF: It has happened countless times in history. First the politician is king. Then greed takes over, the politician wants to perpetuate his power by giving the people "what they want" (actually the politican is buying votes, so greed becomes king). And along with greed and the lust for power comes inflation. Thus, the government degrades (inflates) the money as it prints its way into perpetuating itself (if you can't produce real wealth, then at least you can print it).

Next, the people become disillusioned, because they know in their hearts that the "new prosperity" has all been borrowed from the future and from savings via the printing presses and inflation. Nothing keeps pace with inflation in its latter stages, and despite the illusion of wealth, people find themselves simply running up the down escalator.

Finally, the store of real wealth, gold, comes to the fore, and men turn to the yellow metal because it can't be printed, multiplied, degraded or voted out of existence. In the end the whole paper money structure crumbles, the house of cards collapses and deflation is king.



I have drawn this little chart to illustrate the fact that we are now in the phase where nothing keeps pace with inflation (the cost of living). This is a percentage chart, showing the percentage of advance or decline in the three indicators since 1962 or over the last decade. Note first that bonds have been a disaster, having lost almost 17% of their value since 1962. On the other hand, the D-J Industrials have increased in value since 1962 but they are up only 21.8%. And it may come as a surprise to see that the real winner since 1962 has been the cost of living. Few items, few stocks, few investments have kept up with inflation, the galloping destroyer.



It seems to me that the forces of inflation are now in their terminal stages. It is taking more and more of the gross national product to produce a dollar of earnings. Workers are pressing for whopping wage boosts in a vain attempt to keep up with rising costs. The Government continues to print money, it continues to run huge budget deficits, and trade deficit widens as exports drop off and imports rise. And perhaps most ominous, our trading partners, the people who are stuck with our dollars, have finally moved to protect themselves.

I include a second chart (courtesy of Stock Market Alert, 189 De La Warr Rd., Bexhill-on-Sea, Sussex, England) which shows rather dramatically what has happened to the purchasing power of the dollar since 1950. I have drawn two trendlines on the chart, one measuring the angle of erosion from 1950 to 1972 (trendline A) and another and steeper trendline (b) measuring the angle of erosion from 1967 to date.

One thing is obvious. The kind of deterioration in the dollar's value illustrated on this chart cannot continue. I do not think, for one thing, that our foreign creditors (who hold over $60 billion in eroding dollars) will put up with it. In other words, I feel that this chart shows that the inflation fuse is lit. Something is going to have to blow soon.

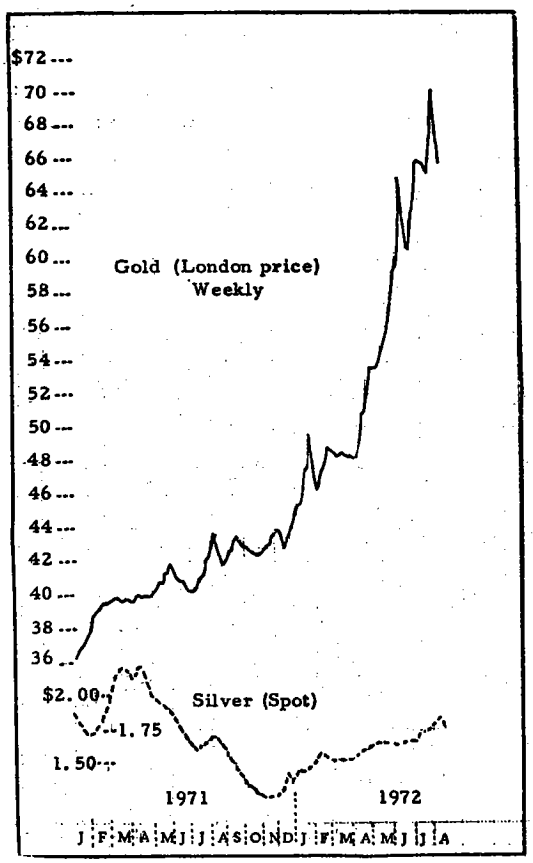
Across the face of the earth the story is pretty much the same, however, and it is one of eroding values. Perhaps that is why the ecology movement has started, not so much because the earth itself is being destroyed by men (it has been going on for years), but because men are beginning to notice it — and protest.

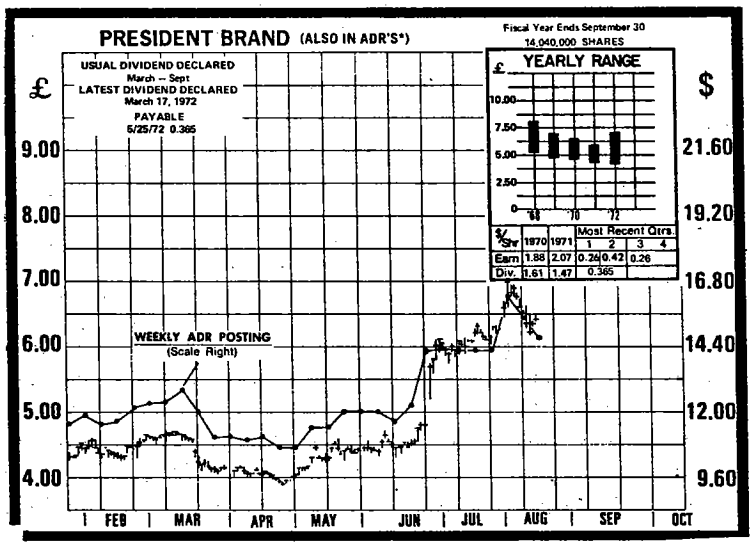
Strange, but I see this whole problem reflected in the dilemma of the stock market. The market is ambivalent. On the one hand, it wants to go up in order to protect itself from inflation and the erosion of the value of the dollar (a piece of a company is worth more than a piece of green paper). On the other hand, the market senses the destruction of values which is in progress due to inflation, and this has long-term deflationary implications. Thus the 364 point range in the Dow since early 1966. The forces of inflation (immediate) against the forces of deflation and destruction (longer term). The result has been a long, frustrating stand-off for the market within a primary bear market.

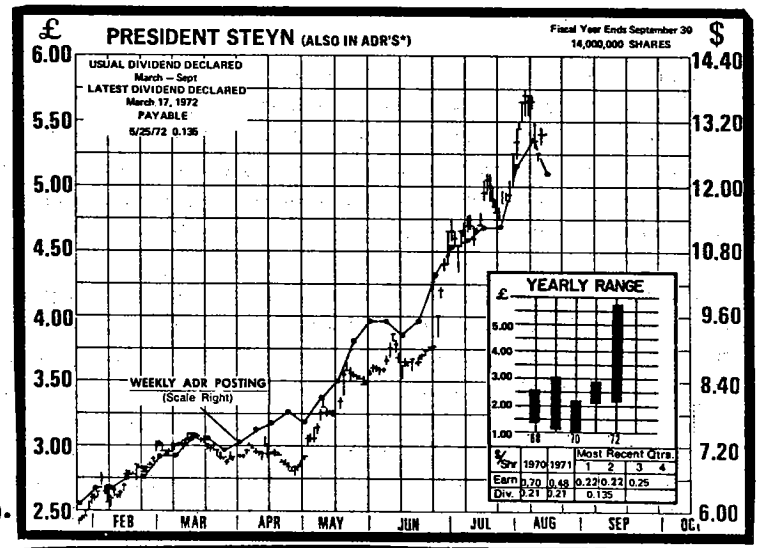
GOLD, MONEY: As seen on the regular page 6 gold-silver chart, the price of gold has held steadfastly above $65 dollars on the current correction. I take this as a sign of outstanding strength, the implication being that buyers are picking up all the gold bullion at $65 they can get their hands on.

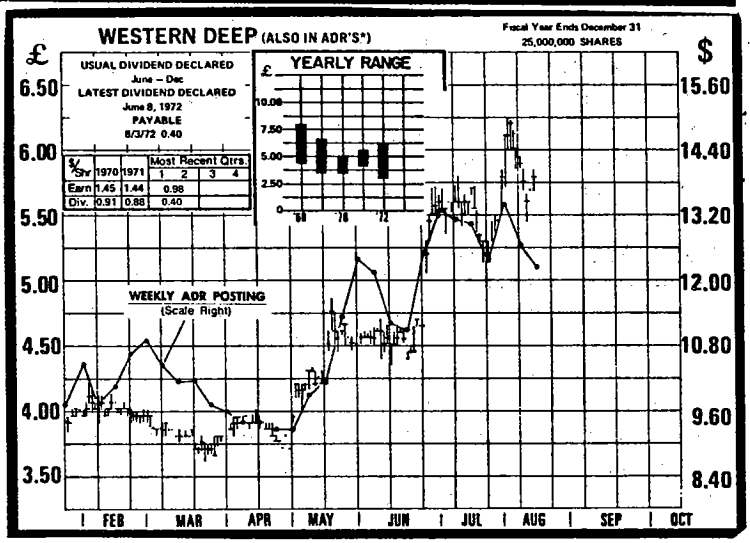
On August 7 the Wall Street Journal ("Outlook") drew attention to what many shrewd investors around the world have known, that inflation is rampant everywhere. The money supply in European countries is booming. In Britain, the money supply over the past five weeks has rocketed at a 42% rate! In general, said the Journal, the growth of the money supply in Europe is "beginning to acquire a Latin look." Figures; W. Germany up at a 13% rate, Italy at a 16% rate, 12% in France and 20% or more in Iceland, Switzerland and Finland.

Said Reuters on August 7, "The gold break out is taken to be a show-down between gold and paper currencies as a whole rather than between the dollar and other paper...." What is happening is incredible, it seems unbelievable in view of Europe's previous disastrous experiences with inflation. My only conclusion is that Europe is gritting its teeth and waiting until the US election is past. Then, it must get down to business or witness what threatens to be a world currency crisis and an ultimate panic out of all paper (fiat) currencies.









I am including three S. African stocks (with ADR's) from charts by courtesy of Kaffir Chart Service, Palisades Pk., NJ 07650. Solid lines connecting dots are the ADR prices, and notice that there is often quite a difference in spread between the London price and the ADR price (this is technical and would take quite a bit of explaining). At any rate, although all three of these issues are up this year, their performances have varied widely with President Brand up around 25%, Western Deep the same and President Steyn about doubled in price.

SPECIAL: I was one of the first of the advisory services to sell financial books. Some books were so rare I had to actually reprint them. Now I am going out of the book business as I feel I have performed whatever service was needed.

I have stock of three books which I feel would be well worth placing in every investor's library. Here they are. The Dow Theory Explained by Stansbury, an excellent basic book which was sold for years at $2.95. Price now $1.50. Making the Dow Theory Work by my friend Shumate and Fritz, a wonderful classic which has sold for $3.95. Price while they last $2.00. The Dow Theory Today, by Richard Russell and sold for $4.95. Price now $2.00. I doubt if any of these books will ever be offered again. Please send checks, I'll pay the postage. Price for all 3 books, $5.00.